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TAGS: ETRD WTRO ECON PGOV FR
SUBJECT: PRESIDENT SARKOZY AND FRANCE'S INDUSTRIAL POLICY

Classified by Economic Counselor Stuart Dwyer for reasons 1.4 (b) and (d)

Summary

¶1. (C) President Nicolas Sarkozy's calls for a more aggressive industrial policy have elicited criticism in some quarters of the EU, but largely favorable responses at home. Sarkozy's perspective is in line with France's long-time perception of an EC liberal "bias" (a perception partly behind the "No" vote to the 2005 referendum on the EU's constitutional treaty). Sarkozy advisors downplay what they see as alarmist reactions to his (successful) efforts at eliminating competition language from the pQamble of the EU cQtitutional treaty, saying the president believes in competition principles, but as means rather than an end. While presumably this elevates other "means" - including state intervention - to equal standing, Sarkozy will be pragmatic in choosing his battles. Rather than attack the foundations of EU competition policy, he is likely to assert GOF interests in discrete cases where he can be reasonably certain of success. End Summary.

Why an EU Industrial Policy?

¶2. (SBU) Following France's rejection of the European constitutional treaty in 2005, interpreted by many as a protest against French powerlessness in the face of rampant EU "liberalism," Nicolas Sarkozy and a majority of his UMP Party extolled the virtues of a European Union that would "sustain globalization while controlling it and protecting from it." In the run-up to presidential elections, many French economists with whom Sarkozy consulted, including pro-market thinkers Elie Cohen and Jean-Paul Fitoussi, told him that France's challenge lay partly in the "absence of an economic and industrial policy."

¶3. (SBU) What they meant was largely a perceived lack of coherence in the government's approach to encouraging innovation and R&D. This diagnosis was in line with a clutch of French parliamentary and government-sponsored reports published since 2005 (including by the UMP's committee on "industrial voluntarism"). Among them, a 2005 report authored by former St. Gobain Chairman Jean-Louis Beffa, at the behest of Jacques Chirac, recalled that many of France's successes -- aerospace, nuclear engineering, electronic components -- were the result of a "triptych of public research, public enterprise and public procurement." Beffa's report concluded nonetheless that such an approach was no longer appropriate. But the nostalgia was barely concealed, and the conclusion -- that well-targeted government intervention, particularly in favor of innovation, is critical to maintaining France's industrial fabric - informs Sarkozy's calls for a "multifaceted

industrial policy" that can deliver both "growth and legitimacy."

¶4. (SBU) Sarkozy broached industrial policy issues during the Paris Air Show on June 23. Speaking before the management of the European Aeronautic Defense and Space Company (EADS), he restated the need for a "real European industrial policy" founded on the principle of "reciprocity and common European interests," rather than one "subordinateQ to competition policy. He pointed to the economic decline of Europe, arguing that if present trends continued, in 20 years the average U.S. citizen would be twice as rich as the average Frenchman. Implying that the public sector's role in promoting industry (through R&D spending, support for small business and other measures) was partly responsible for the performance gap, Sarkozy said that France and Europe should implement industrial policy "with the same freedom of interpretation as that which our American, Chinese, Indian or Brazilian friends allow themselves."

Alstom and Sanofi as Precedents

¶5. (C) Sarkozy's industrial policy combines support for innovation with a willingness to intervene when he believes he better understands what's right for France and its economy than does the marketplace. He undoubtedly sees Alstom's return to strong profitability following the 2004 GOF bailout of the company (while he was Minister of Finance) as vindication of his approach. (Never mind that conditions imposed by the EC forcing Alstom to sell off assets and open itself up to cross-border partnerships were at least as critical to the company's long-term health as

the injection of state cash.) And his apparent success in helping convince Sanofi to sweeten its hostile takeover bid of Aventis in 2004 to create a French national pharmaceutical champion is likely to have further confirmed him in his instincts for using the political process to shape outcomes, quickly.

¶6. (C) Sarkozy may be driven by a more expansive definition of market failure (one that includes a healthy dose of Gallocentrism) than many of his EU counterparts; but the risks to France's -- and the EU's -- competitive environment should not be exaggerated. Sarkozy is unlikely to embark on what he knows would be a futile frontal assault on EU competition policy. He will choose his battles carefully, and is likely to intervene only when he believes he is not leaning into a heavy wind. A reprise of the rhetorically-charged flap over the 2006 Mittal/Arcelor marriage, when shareholder interests were strongly at odds with initial French (and other European) government views, is unlikely. In an early test (admittedly mild, given that thorny questions over the shareholder's pact were not in play) Sarkozy came down in favor of a more streamlined commercially-viable management structure for EADS, even though it puts Toulouse-based Airbus under the control of a German.

¶7. (C) On the other hand, the Sarkozy government displays no more enthusiasm for liberalization of the energy sector than did its predecessor. The prevailing view is that strong integrated companies are required to deal with cartel-like suppliers, and ultimately offer consumers a better deal. Reports that EC Competition Commissioner Neelie Kroes has opened procedures against EDF for its long-term low-cost power contracts with French industry will only confirm the Sarkozy government in its thinking that Brussels focuses excessively on the theoretical benefits of competition. It is not surprising that one of the more prominent rumors here has the Sarkozy government pursuing a buyout of Siemens' stake in nuclear giant Areva, with the long-term goal of encouraging an Areva-Alstom-

Bouygues tie-up and creation of French power plant construction champion. The rumors are unconfirmed, and the project may be a bit ambitious even for this government, but the scenario is consistent with Sarkozy's modus operandi.

Fault Lines in the Government?

¶8. (C) While Sarkozy clearly has his own well-formed views on the subject ("It is not a right of the state to help industry, it's a duty," he said as Finance Minister in 2004.), as on many subjects he has surrounded himself with advisors who will offer conflicting views. Sarkozy's Secretary of State for Enterprise and Foreign Trade, Herve

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Novelli, comes from the liberal wing of the UMP and in 2006 was openly critical of Sarkozy's anti-ECB, "EU must tame the market" rhetoric. Novelli has established his own Council of Entrepreneurs that will meet for the first time in September to help inform work on a law on the modernization of the economy (to be prepared for spring 2008). The law will focus on improving the business environment and promoting exports. Elysee officials tell the Embassy that Sarkozy Chief of Staff (Secretary General) Claude Gueant is also firmly in the liberal camp of advisors.

¶9. (C) But sitting on the opposite side of Sarkozy's office from Gueant, Special Advisor (and former campaign speechwriter) Henri Guaino will undoubtedly encourage the president to maintain an expansive view of the state's role in the economy. Guaino, who oversaw France's Commissariat General du Plan in the 1990s (the now defunct organization that in its heyday implemented the GOF's five year plans), has on numerous occasions lamented Brussels' intrusion on the French model of public service. Following energy market discussions at the 2002 EU Barcelona summit, Guaino complained of a "dominant (EU) ideology" that sees competition "as the solution to all problems and that is always efficient, even when, as in the case of electricity, it is not true."

¶10. (SBU) At the time Guaino complained that the "ideology of competition" had taken hold of European institutions "from the very start." France was "paying the price" for having ratified treaties and texts that enshrined the principles of competition, but which called into question France's notion of public service. Guaino said (in the context of power sector liberalization) there was no going

back on competition issues, and "no choice" but to assume the consequences of those decisions and "do as much as possible to ensure that we lose as little as possible." More recently, asked in a July 22 interview with Le Monde whether he "didn't like competition," Guaino said it was critical not to create a false opposition between markets and the political process. Even the "most liberal economies" were a mixture of "organization and market." The most effective approach involved a successful marriage of public sector strength and private initiative, he said, citing the United States and Japan as examples.

Marching Orders to Minister Lagarde

¶11. (SBU) For now many aspects of Sarkozy's industrial policy remain amorphous. His July 11 "letter of mission" outlining priority foreign economic policy objectives for his Minister of Economy, Finance and Employment, Christine Lagarde, dealt largely in generalities (in contrast to the domestic portion of the letter, which went into considerable detail). Sarkozy tasked his minister with improving France's international competitiveness by

rationalizing tax policy. Lagarde was asked to generate a policy of economic intelligence to develop and reinforce French centers of research and development, and to encourage the excellence of its financial centers. The president wrote that "it is in improving the quality of our products that we will conserve our industry, improve our trade balance and increase our purchasing power." Lagarde is to work with EU partners in developing an industrial policy and boosting R&D efforts that help to retain industry. And she is to develop measures to encourage "popular shareholding" so that the French can "own their largest companies and multinationals."

Next steps

¶12. (SBU) Sarkozy has asked former Foreign Affairs Minister Hubert Vedrine to prepare a report by mid-September on France's - and the EU's -- role in the world, to include concrete initiatives that "reflect (France's) ideals, values, as well as better defend (her) interests." At the same time, Sarkozy's UMP party has appointed National Assembly member Bernard Carayon to head a new Committee on Globalization. Vedrine has been described by former Socialist Minister of European Affairs Pierre Moscovici as a "protectionist." As for Carayon, whose thinking on industrial strategy underpinned the government's policy of "economic patriotism," he has called for an end to French and European "masochism" which benefits "our competitors in the name of dogmatic and naove liberalism."

U.S. Interests

¶13. (SBU) Despite the rhetoric, U.S. business in France is relatively sanguine about Sarkozy's policy line. In a recent meeting with visiting U/S Reuben Jeffery, AmCham members focused more on the potential upside of Sarkozy's domestic reform agenda than the pitfalls of the president's "political voluntarism." Managing Director of KKR France Jacques Garaialde told Jeffery that French political interest in his firm continued unabated, but that the focus was not so much on the flag of the capital but rather on the impact of investment on management and jobs. Garaialde noted that KKR had recently taken a majority stake in the French Yellow Pages with barely a hiccup.

¶14. (SBU) Goldman Sachs Managing Director Jean Raby echoed those views, saying he expected Sarkozy to proceed pragmatically. "If Sarkozy looks back on Alstom, he could probably conclude that it turned out quite well." But the president would be unlikely to wade into deals where he couldn't be assured of success, he thought. Raby acknowledged a strong political interest in the "kind" of capital behind certain investments in France, an interest that had been made explicit during the MittalQakeover (Goldman officials, as bankers to Mittal, had testified before the French Senate on that deal). While he thought there was a continuing naivete in the French political class about the long-term benefits of unimpeded capital flows generally, he did not think the Sarkozy government would be a step backwards for U.S. interests.

Comment

¶15. (C) Sarkozy's efforts to loosen the rigidities in the French system -- assuming they don't get watered down -- may, over time, create the kind of dynamic economy that could weaken the political appeal of interventionism. In the nearer term we can expect inherent tension as Sarkozy bumps up against the strictures of competition policy, and pushes the envelope with his EU partners on issues ranging from the exchange rate to "economic government." We have

an interest in how these issues play out, but our EU partners will be better-positioned to engage directly. We would do well to quietly encourage Sarkozy's efforts at reform, while paying careful attention to ensuring that any GOF efforts to create a more muscular industrial policy do not set back the global investment environment.

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